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FALL 1990 VOL. 122, NO. 11

FORTUNE

Investors this fall will have to navigate perilous seas like this one, painted by Robert Crawford. Cover designed by Fran Fifield.

INTRODUCTION: HOW TO PROFIT IN A WORLD OF CHANGE 12

INVESTMENT STRATEGY AND VEHICLES

SAFE-HAVEN STOCKS FOR A RISKY MARKET 14
Pick from recession-proof companies in these worrisome times, especially growth stocks, and from the energy sector. *by Andrew Evan Serwer*

IT'S TIME TO BE CAUTIOUS WITH BONDS 21
As interest rates bob, stay with quality and medium maturities. *by Joshua Mendes*

REAL ESTATE: A FEW GEMS IN THE ASH HEAP 25
Some say property values have hit bottom, but prepare to sift. *by Karen Nickel*

GOLD'S PRICE ISN'T GOING ANYWHERE 29
Barring war or hyperinflation, investors can count on no big ride. *by Susan E. Kuhn*

THE BEST MUTUAL FUNDS 31
In a rough period for stocks, punctuated by the crash and the invasion of Kuwait, bond funds were winners. *by Joshua Mendes*

THE STARS TELL HOW THEY'RE PLAYING IT NOW 45
Managers of 13 top-ranked funds spell out where they see promise and peril.

A WINNING STRATEGY FOR THE 1990s 56
The new decade won't be as kind as the 1980s—it may be much like the 1960s—but by adapting to new trends, you can prosper. *by Brian Dumaine*

MORGAN STANLEY'S VIEW OF THE WORLD 64

THE BEAUTY OF COMPOUNDING 68

A NIFTY FIFTY FOR THE NINETIES 72

THE PROS SHARE THEIR SECRETS 75
Successful money managers aren't afraid to buy when everyone else is panicking. Three at the top offer advice for amateurs. *by Brett Duval Fromson*

SEVEN PEARLS FROM PETER LYNCH 78

LESSONS FROM A LAZY AMATEUR 85
The no-sweat way to win with stocks: Hold good companies that pay rising dividends. Finding them isn't as hard as you think. *by Edmund Faltermayer*

WHY INVESTORS SHOULD GO GLOBAL 97
Having part of your stake invested abroad lessens risk and may increase returns too. *by David Carey*

"There are just too many bears around for me not to be bullish."

PAGE 45

"Know what you own. You should be able to explain in two minutes to a 12-year-old why you own a stock."

PAGE 75

Only one thing will grow faster than the children in this family: the bills.

PAGE 116

"Bringing down the cost of health care is the single greatest opportunity for long-term investing."

PAGE 137

"Suing your broker has never been easier. With arbitration it is fast and simple."

PAGE 207

ASSET ALLOCATION

ALLOCATING YOUR ASSETS FOR LIFE 113
Five financial experts from across the nation suggest how to match a personal portfolio to the investor's age and circumstances. *by Terence P. Paré*

TWENTYSOMETHING 114
She is single, earning $35,000 a year, and just inherited $25,000.

THIRTYSOMETHING 116
They're married, with kids 3 and 4, an annual income of $75,000, and $100,000 to invest.

FORTYSOMETHING 120
They earn $100,000 a year and have a nest egg of $150,000—but their three children are approaching college age.

FIFTYSOMETHING 124
Newly divorced and facing alimony payments, he earns $200,000 a year and has $500,000 to invest.

SIXTYSOMETHING 126
They are retiring on pensions totaling $85,000 a year, and together have accumulated $1 million.

THE OUTLOOK

A YEAR TO SWING BOTH WAYS 131
As the economy trudges along, higher interest rates and profits will offer investors their choice of rewards. *by Todd May Jr.*

INDUSTRIES WITH PROMISE IN 1991 137
The coming year will inevitably produce companies in the right place at the right time. From home health care to fabric retailing, FORTUNE helps you spot them now. *by Patricia Sellers*

STOCKS YOU SHOULD SHUN 161
Sure, you can spot a lot of apparent bargains in the market right now. But not all of them are worth snapping up. *by Mark Alpert*

TAXES AND INVESTING

WHAT'S CERTAIN ABOUT TAXES 165
Not a whole lot. But while Washington dithers, you should get ready for just about anything. Here's how. *by Robert E. Norton*

TAX TINKERING: WHAT IT MEANS TO YOU 168

WHAT TO DO WITH A BIG PAYOUT 179
To make retirement capital last, study strategies carefully—and beware of sharks. *by Anne B. Fisher*

SOME ADVICE ABOUT ADVISERS 186

MUNIS: THE LAST OF THE TAX HAVENS 189
With higher taxes brewing from Capitol Hill to California, municipal bonds are looking better than ever. *by Susan E. Kuhn*

SOURCES OF HELP

CAN YOU TRUST ANALYSTS' REPORTS? 195
The Wall Street pros may be your source of information on stocks, but be careful how you use their advice. *by Anne B. Fisher*

WHEN EXPERTS ARE PROVEN WRONG 202

THE NEW RULES OF SUING A BROKER 207
Settling disputes through arbitration rather than in court works for investors. *by Lloyd S. Clareman*

HOW TO INVEST WITH YOUR PC 211
Electronic databases can help turn that overpriced calculator into a valuable investing tool—without turning you into a techno-nerd. *by Joel Dreyfuss*

DEPARTMENTS

EDITOR'S DESK 4

INDEX 8

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EDITOR'S DESK

THE WORST of times for people who invest can be the best of times to seek specific advice on where to put your money for safety *and* growth. And these certainly seem like some of the worst of times. Nothing is certain, from the political powder keg in the Middle East to the volatile markets in stocks and bonds. Even the most conservative of investments—cash in an FDIC-insured bank—feels like a gamble, given the parlous condition of the Federal Deposit Insurance Corp.

So the timing is propitious for our sixth annual Investor's Guide. It provides plenty of calm counsel on topics including the investment fundamentals that you need to plan for the 1990s long term and the best ways to cope with short-term market gyrations.

This year's Guide is edited by John Curran, our Personal Investing editor. An investment fan as boy and man, Curran bought his first stock before his voice changed and has been writing about the markets since 1976. Leading the crew of 40-plus who put this issue together through such a rocky period was a special challenge. Says Curran: "You feel like the deck officer of an aircraft carrier, managing a flurry of night landings in the middle of a storm."

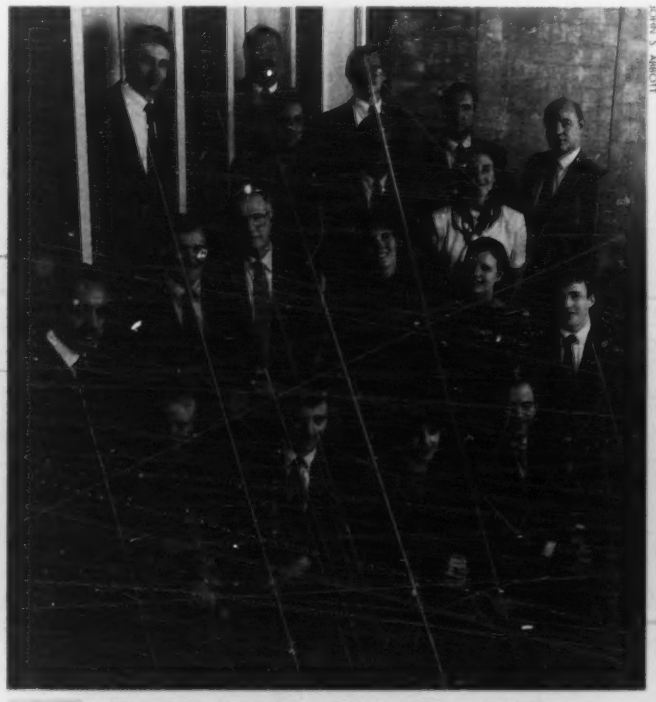
Well, speaking of rough times, we still remember the day our Investor's Guide came out three years ago. It hit the newsstands October 19, 1987—Black Monday, when the stock market plunged 508 points. Now that *was* one of the worst of times, and, as it turned out, among the best of times to scoop up bargains. People who followed the Guide's advice did extremely well.

More than ever, this year's Guide provides the tools to map out a comprehensive strategy. For example, writer Brian Dumaine's article on how the 1990s will be different for investors not only dissects the trends for the new decade but also provides invaluable perspective. As Dumaine says, "If you understand how markets work, you'll save yourself a lot of sleepless nights."

We think this is our best-looking Guide yet. Credit goes to designer Barbara Smyth and to Mark Rosenthal, who crafted all the issue's charts. Says Smyth: "We wanted it to be very people-oriented and user-friendly." We trust that you will find exactly what you want—sound, timely, useful advice for an uncertain world.

Marshall Loeb

MANAGING EDITOR



JOHN S. ABBOTT

Editor Curran (seated center) with the Guide's crew

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SAFE-HAVEN STOCKS

PICK FROM RECESSION-PROOF COMPANIES, ESPECIALLY GROWTH STOCKS, AND FROM THE ENERGY SECTOR.

■ BY ANDREW EVAN SERWER

INVESTORS this fall must feel like Ulysses and his men sailing on an endless voyage through perilous seas. Will they ever make it home? Between the uncertainties in the Middle East and recession fears, "land ho!" may be a while coming. Owning stocks is more than a little discouraging right now, because the market has been tacking southward since the Dow Jones industrial average reached a record 2999.75 in mid-July. Few market seers find any reason for stocks to rebound dramatically. And if you're thinking of switching to bonds, real estate, or commodities, the articles that follow suggest only selective pickings there.

It's far from the worst of times, however. Those who closely watch technical indicators see favorable blips, and some stocks already appear temptingly cheap. A few hardy souls are cherry-picking right now. Among them is Harold Mackinney Jr., president of Fleet/Norstar's investment advisory firm in Providence. Says Mackinney, whose outfit runs a cool $13 billion: "The market looks like a candy store if you don't think the world is going to end."

For the time being, investors should limit themselves to a select group of safe stocks. But be prepared to step up buying at the first sign of the sun peeking through the clouds.

The pessimists have no trouble building a case. Though some economists refuse to proclaim a recession, slow growth seems almost certain to continue over the next several quarters (see The Outlook). To make matters worse, high oil prices could nudge up inflation. Fear of the icebergs and shoals of recession and inflation has driven some melancholy investment strategists to discuss 2000 on the Dow as a serious possibility. Only with prices one-third lower than their recent highs, growl these bears, would stocks

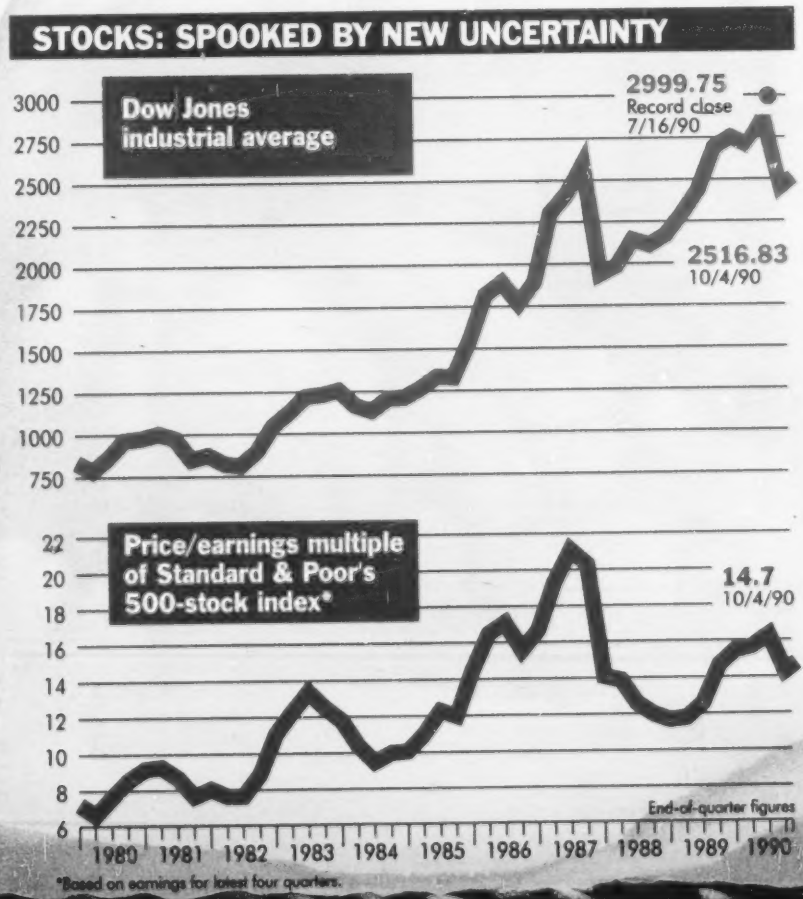
FOR A RISKY MARKET

appear enticing. "The danger from here is not a quick fall but more of a long, insidious slide," says Dean LeBaron, chief investment officer for the $7 billion piloted by Boston's Batterymarch Financial Management.

Even with the market off about 15% from its peak, most stocks are not cheap, especially if recession haunts you. The price/earnings multiple of Standard & Poor's 500-stock index stands at 14.7, quite a drop from its recent high of 17 but still way above an average of 9 during the past three recessions. For the market to sell that low, the Dow would have to thump all the way to 1600. While few predict anything so catastrophic, other barometers suggest the market could keep drifting down for a while. With the S&P 500 dividend yield at 4%, below the 6% reached in some past bear markets, it's hard to say the market has hit bedrock on that basis.

Steven Einhorn, chairman of the investment policy committee at Goldman Sachs, is one strategist who wouldn't be surprised to see the market head for the tropics this winter. "Stock prices just don't yet reflect all of the weaknesses inherent in the economy," he says. According to Wall Street analysts' forecasts of earnings per share, as compiled by the Institutional Brokers Estimate System, the consensus calls for 7% growth this year and 15% for 1991. Wishful thinking, says Einhorn, who sees zero growth in 1991. Plugging his numbers into a dividend discount model, which weighs the relative value of stocks and bonds, Einhorn figures the market is 12% to 15% overpriced.

Many economists, who focus on operating profits rather than earnings per share, hold a somewhat brighter view, reflected in FORTUNE's forecast. But Wall Streeters, even those counting on improved earnings per share, are concerned about a dropoff in the quality of earnings. They are overstated at least 10% by the effect of inflation on inventories and the gap between depreciation charges and true replacement costs. Low-grade earnings do not bode well for dividends. According to Standard & Poor's, the number of companies increasing dividends is down 22% in 1990, while payout cuts



WHAT THE HECK DO I DO NOW?

STOCKS

■ For now, concentrate on growth companies and those whose sales hold up in recessions. Some of the pros like natural gas stocks and expect the run in oils to continue. But the bears are growling, not without reason, so don't stray far from the low-risk stuff.

BONDS

■ The watchwords are safety and intermediate-term maturities. Between worries about inflation and recession, plus the uncertainties in the Persian Gulf, interest rates have been dancing up and down. Best bet: seven-year Treasury bonds yielding a fat 8.6%.

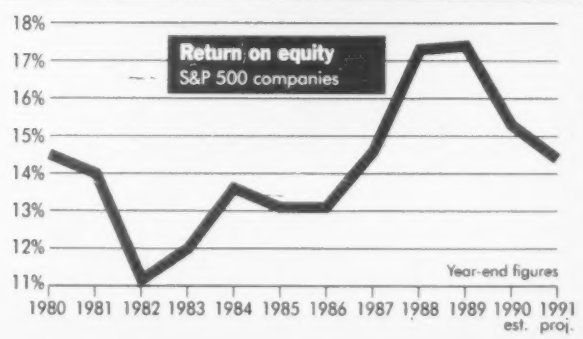
REAL ESTATE

■ Lots of wreckage here. Nevertheless, a few jewels now look cheap, especially some well-run real estate investment trusts with low debt, good occupancy rates, and dividend yields heading above 9%. Also worth a close look: health care REITs.

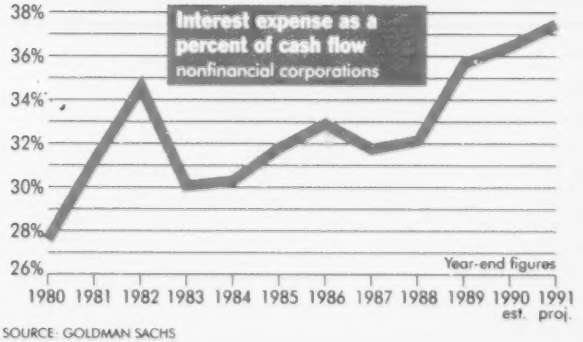
COMMODITIES

■ Gold is in a price rut, likely to remain at roughly $400 or so an ounce because inflation jitters aren't strong enough to move the metal higher. Only a war with Iraq could lift gold as high as $500. The commodity experts foresee lower copper and grain prices.

PROFITS ARE FALLING . . .



. . . AND THE INTEREST BURDEN IS RISING



SOURCE: GOLDMAN SACHS

LEAN TIMES ARE HERE

Companies are finding it tough to raise prices these days. So return on equity, based here on operating earnings, is down even though equity has thinned.

In good times or bad, debt has to be serviced. With profits off, interest costs are eating up a higher proportion of corporate cash flows than they have in years. One result: fewer dividend increases.

are up 48%. Reason for the chopped dividends: too little profit and too much debt.

Debt was widely perceived to be a magic elixir in the 1980s, when stock prices levitated as management borrowed heavily for takeovers and leveraged buyouts. Today, with banks holding back on the credit that fuels deals, merger mania is history. *Mergerstat Review*, published by Merrill Lynch, reports that the dollar volume of mergers and acquisitions is down $66.3 billion, or 44%, so far this year. Gone are the premium prices that scores of stocks commanded as potential takeover candidates. Says LeBaron of Batterymarch: "The broader market indexes began to decline when dealmaking died out in the fourth quarter of 1989."

Debt worked wonders another way. Leveraging up balance sheets reduced the equity portion of companies' capitalization, which translated into a higher return on equity from the same profits. Even amid lofty debt levels, ROE has been declining of late. Sluggish sales have made it difficult for companies to raise prices, and this has cut into profit margins. Worse, a huge chunk of companies' cash flow is now garnisheed for debt service. According to Goldman Sachs, which defines cash flow as pretax profits plus depreciation, capital consumption adjustments, and interest paid, interest expense will devour more than 37% of cash flow in 1991 (see chart).

FORGET ABOUT foreign aid for the stock market. Cheap stocks, robust economic growth, and deal mania drew foreign investors to the U.S. market in the 1980s. With the domestic economy slowing and interest rates rising abroad, overseas buyers are saying *sayonara*, *auf Wiedersehen*, and cheerio as they move their money to Europe and the Pacific Rim. Einhorn of Goldman Sachs points out that foreigners have liquidated $8 billion in U.S. equities to date this year, a record by far. Says he: "There's nothing I see to suggest that they are coming back anytime soon."

Before you hibernate with the bears, however, take note of a few cheerful signs. Elaine Garzarelli, quantitative analyst at Shearson Lehman Brothers, says one bullish factor she cranks into her forecast is the bearishness among investment advisers. *Investors Intelligence* of New Rochelle, New York, finds that 52% of surveyed advisers are downbeat. Any reading over 50% is a favorable omen. Then

REPORTER ASSOCIATE *Laurie Kretchmar*

there's an arcane little gauge called public-to-specialist shorting, or the ratio of short-selling by the public to that of in-the-know hotshots. Anything above .60 is considered bullish because it suggests that the amateurs are becoming more negative than the pros consider appropriate, and lately the needle has been at .98.

OFFICERS and directors of companies are sanguine too. The *Insiders* newsletter of Fort Lauderdale, Florida, reports that 78% of all recent insider trades were buys, more than double the perennial average of 35% and close to the record high of 89% after the 1987 crash. Newsletter editor Norman Fosback is keen on several stocks that insiders are snapping up, including **Chrysler**, **Maytag**, and **UNC**, which makes and repairs jet engine parts.

Mackinney of Fleet/Norstar, using a formula he calls the "the rule of 18.5," figures the market should be up near 3000. The formula assumes that over time the sum of the inflation rate and the average price/earnings multiple of the Dow stocks tends to home toward 18.5. Mackinney sees inflation staying at around 4% on the consumer price index. Ergo, the P/E of the market on next year's earnings should be around 14.5 instead of the recent "forward" multiple of 12, putting the market back at its all-time high. Even at the 6% inflation rate FORTUNE expects next year, Mackinney's formula would boost the Dow 100 points. "I think we will figure things out in the Middle East within the next six months," Mackinney says. "Then energy prices will be back down quickly to the low 20s per barrel of oil."

So what to buy? Mackinney is eyeing bank stocks—warily. Shares of such money center banks as **Chase Manhattan**, **Chemical Banking**, and **Citicorp** have plummeted more than 50%. Like many experts, Mackinney thinks they have yet to hit terra firma. But elsewhere he sees sound buys. He likes **Dow Chemical**, selling at $39 with a $2.60 dividend. **AMR** has gone from $107 to $42. "Yes, the airline is being hurt by higher fuel costs, but not that much," he says. He favors **Ford Motor**, which sells for $31 and comes equipped with a $3 dividend.

To participate in this market, investors should look first for shares in certain stock groups—such as drugs, liquor distillers, and tobacco—that tend to perform better than others during recessions (see table). These stocks generally hold up well, since people go right on taking pills and sipping cocktails when times are bad. Most experts doubt that proposed tax increases will significantly cut into sipping or smoking. Because of the troubles in the Middle East, oil stocks and precious metal shares were recently the place to be. They were also stars in the 1973–75 downturn, which was partly brought on by OPEC's first oil price shock.

Many analysts expect the run in oil stocks to continue. They are even more bullish about gas pipeline companies, which benefit because some industries turn to gas when oil prices rise. Charles Clough, chief investment strategist at Merrill Lynch, recommends gas stocks with respectable dividends. He likes **Consolidated Natural Gas**, which yields 4%, **Sonat** (4.1%), and **Enron** (4.4%).

Einhorn likes energy companies, but he likes growth stocks even more. "Relative stock price performance follows relative earnings growth," he says. "Over the next year or so, growth stocks will be the ones turning in the best earnings." He sees dividends of growth companies pushing ahead 15% next year, compared with 5% for the rest of the market. These stocks are also selling for a smaller premium than usual over other stocks. Among Einhorn's picks: **General Mills**, **Bristol-Myers Squibb**, **Merck**, and **Philip Morris**.

Oil and natural gas stocks are all right for now, says Garzarelli, who doesn't rule out a nasty economic slump. But she's looking beyond to the next expansion. "Coming out of a recession, your best-performing groups are the consumer durables, such as autos, leisure time, and appliances," she says. Over the past 12 months, she notes, **GM** has fallen 28%, Ford is off 43%, and Chrysler is down 64%. In leisure time, sporting-goods maker **Brunswick** is off 58%, while **Outboard Marine** is down 64%. Appliance maker **Whirlpool** is off by 40%, and **Maytag** is down 47%. "These stocks have been so beaten down," says Garzarelli, "they are already looking attractive."

If she's right, maybe more investors should clamber up for a view from the crow's-nest. F

THE BEST AND THE WORST IN RECESSIONS

PERIOD: 11/73 to 3/75		PERIOD: 1/80 to 7/80		PERIOD: 7/81 to 11/82	
STRONGEST STOCK GROUPS					
Precious metals	45.7%	Precious metals	29.1%	Beverages	29.7%
Coal	19.3%	Oil services	25.9%	Home finance	28.9%
Supermarkets	1.3%	International oil	22.4%	Supermarkets	22.7%
Shipping	–3.5%	Foreign oil	22.1%	Drugs	22.3%
Media	–5.3%	Domestic oil	21.3%	Pollution control	20.9%
Tobacco	–8.1%	Tobacco	19.6%	Publishing	17.3%
Agriculture	–9.2%	Home finance	13.9%	Tobacco	16.3%
Oil services	–9.9%	Railroads	11.5%	Hotels	14.5%
Containers	–14.2%	Liquor distillers	10.5%	Liquor distillers	14.1%
Drugs	–14.7%	Mortgage finance	10.3%	Retailing	12.7%
WEAKEST STOCK GROUPS					
Liquor distillers	–38.8%	Supermarkets	–5.4%	Railroads	–22.4%
Office equipment	–40.1%	Coal	–6.4%	Forest products	–25.6%
Pollution control	–40.2%	Trucking	–6.6%	Foreign oil	–26.4%
Utilities	–41.5%	Shipping	–7.8%	Producer goods	–27.3%
Apparel	–43.0%	Media	–7.9%	Coal	–29.6%
Photography	–43.5%	Soap and cosmetics	–9.1%	Domestic oil	–31.6%
Beverages	–43.6%	Life insurance	–9.5%	Mining	–33.4%
Banking	–44.1%	Oil refining	–10.0%	Aluminum	–38.4%
Tire and rubber	–44.6%	Tire and rubber	–10.8%	Shipping	–46.1%
Real estate	–52.2%	Motor vehicles	–10.9%	Oil services	–47.0%
Mortgage finance	–76.1%	Office equipment	–12.5%	Steel	–49.6%
S&P 500	**–19.6%**		**8.9%**		**9.9%**

SOURCE BARRA

It's timely to look at how stock groups fared in the past three recessions. One industry that outperformed the market in all three: tobacco companies, whose sales held firm.

REAL ESTATE: A FEW GEMS IN THE ASH HEAP

SOME SAY PROPERTY VALUES HAVE HIT BOTTOM, BUT PREPARE TO SIFT. ■ BY KAREN NICKEL

IN INVESTING, bad news—even terrible news—nearly always has its good side. True, the office vacancy rate still hangs high at about 17%. As for illiquid limited partnerships, the question for many is not what to buy but how to get out. The investor's returns from most sectors of real estate are negative these days.

But that can mean opportunity. Over the past year, according to Green Street Advisors, a real estate research firm in Newport Beach, California, prices of equity real estate investment trusts (REITs) fell more than 25% on average, to levels reached in the 1987 stock market crash. The shares, which trade like stocks, are now priced at big discounts from the net asset value of the properties in REIT portfolios.

Many real estate experts think the worst is over. Says John Moran, portfolio manager of San Francisco's PRA Securities Advisors, an institutional real estate investment firm: "You could make a good case that we're at the bottom of the market, but the bottom could last for years." David Shulman, director of real estate research at Salomon Brothers, thinks property prices must sink another 15% before they will reflect true value. But for those willing to sift through the ashes, a few diamonds can be found.

REIT hunters should look for low-debt, well-managed properties and good occupancy rates. Moran likes five REITs that meet these criteria: **Washington Real Estate Investment Trust**, **United Dominion Realty Trust**, **REIT of California**, **Weingarten Realty Investors**, and **Western Investment Real Estate Trust**.

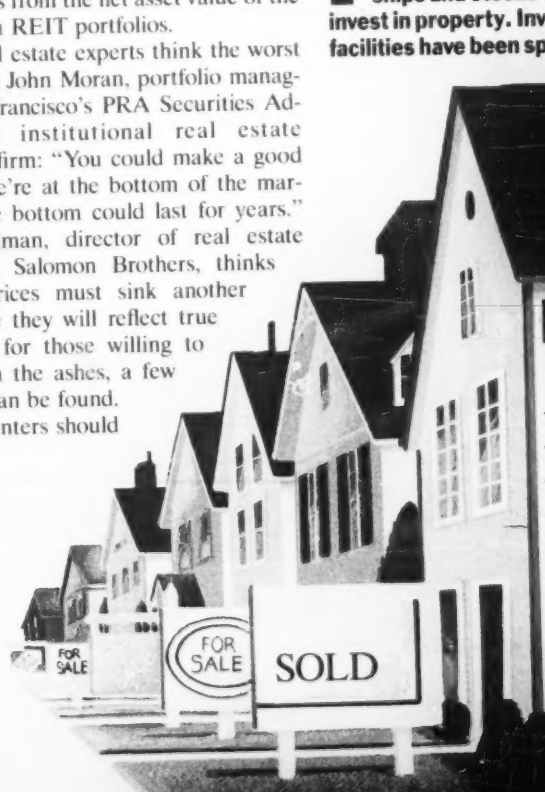
The first two invest in the iffy Southeast and Northeast regions, Moran says, but primarily hold shopping centers and apartments rather than overabundant office space. Houston's return to life will benefit the extremely well-managed Weingarten Realty, he adds, and the relative strength of West Coast real estate should bolster the bottom lines of REIT of California and Western Investment. All five REITs, Moran says, will boost their dividends over the coming year, fattening the average yield to more than 9%. Samuel Lieber, portfolio manager of top-performing **Evergreen Global Real Estate Equity Fund** in Purchase, New York, is especially high on Western.

Green Street's Michael Kirby champions health care REITs, particularly **Health Care Property Investors**. "This is the most conservatively managed health care REIT and turns in a good performance every year," he says. Health Care recently added to its portfolio of nursing homes by signing a deal to buy psychiatric properties at near fire-sale prices.

Lieber has hedged by buying stocks of industrial companies with real estate holdings. One of his current favorites is **I.G. Farbenindustrie**, a corporate fragment of the German chemical combine that was broken up after World War II. The company, traded on the German stock exchanges but available through a U.S. broker, owns eight blocks of prime real estate around East Berlin's main train station. Shares trade around $13.25, says Lieber, but are worth at least twice as much. F

REPORTER ASSOCIATE *Rebecca Lewin*

It's a miserable year for most real estate securities, including partnerships and stocks of companies that invest in property. Investments in health facilities have been spared heavy losses.



ROBERT CRAWFORD

REAL ESTATE'S SCARRED LANDSCAPE

SECTOR	TOTAL RETURN* 1987	1988	1989	1990 through 8/31
Shopping centers	3.7%	19.3%	9.7%	-13.4%
Office buildings	-9.2%	23.2%	2.2%	-30.2%
Commercial mortgages	-8.8%	-3.9%	-23.4%	-36.2%
Land development	-33.5%	30.2%	-20.7%	-42.9%
Industrial buildings	-21.6%	11.3%	-15.4%	-12.2%
Hotels	-24.7%	17.1%	-5.5%	-16.5%
Health care facilities	-1.5%	6.5%	12.8%	-4.4%
Residential mortgages	-21.8%	-7.0%	-7.3%	14.3%

*Including dividends

SOURCE: COHEN & STEERS CAPITAL MANAGEMENT

THE BEST MUTUAL FUNDS

IN A ROUGH PERIOD FOR STOCKS, PUNCTUATED BY THE CRASH AND THE KUWAIT INVASION, BOND FUNDS WERE WINNERS. ■ BY JOSHUA MENDES

SALMON swimming upstream to spawn face the same kind of challenge as stock pickers in the three years through August 31, 1990. Though it soared to new highs in early summer, the market finished downhill from where it started, moving from a lofty pre-crash level to a humbler post-Kuwait one. Not only did most classes of stock funds trail the total return on Standard & Poor's 500-stock index, which is not unusual, but the typical return was also miserable in absolute terms as well. All the more remarkable, then, that a few standout stock funds rang up impressive annual returns. Strong salmon, those.

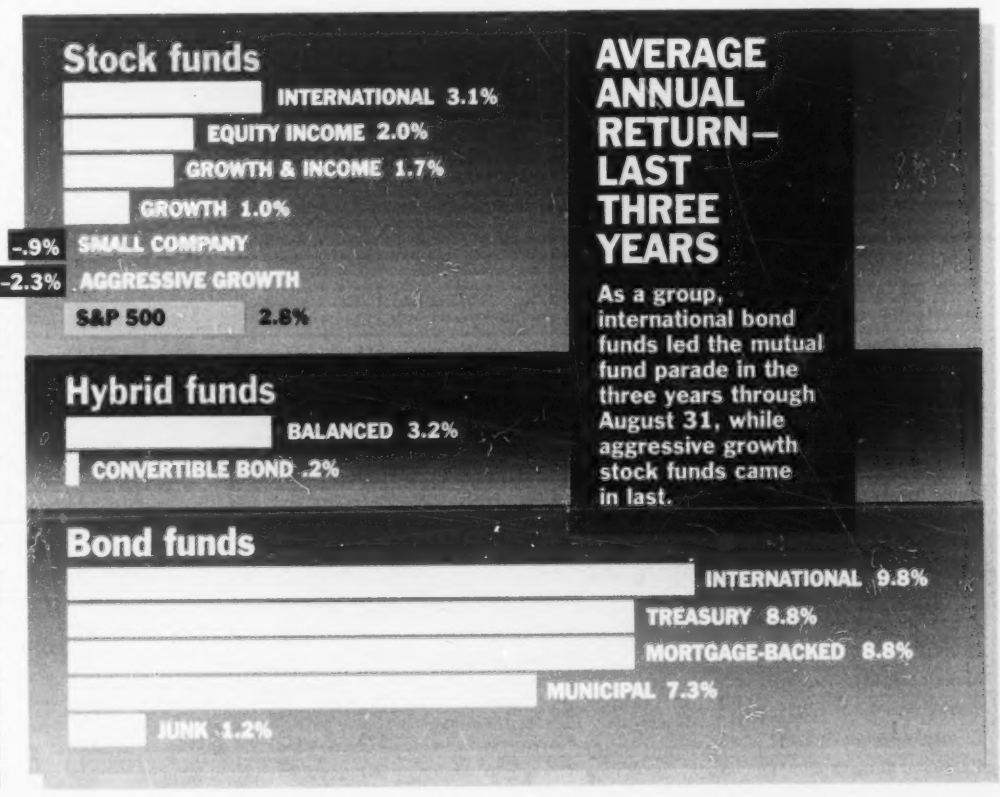
The lists that begin on the next text page—compiled for FORTUNE by Morningstar Inc., a mutual fund rating service based in Chicago—show the top-performing mutual funds in each of 13 categories during this period. The rankings are based on capital gains plus dividends or interest. The categories are generally arranged in descending order of risk, within several broader groupings.

Displayed first is the most nail-biting category of all, aggressive growth stock funds, which often use such techniques as shortselling and high leverage in the hope of winning big. At the other end of the spectrum are staid Treasury bond funds. In between come hybrid funds appealing to middle-of-the-road temperaments, namely balanced funds holding both stocks and bonds, and convertible bond funds. There are also specialty categories, such as funds investing in small companies, municipal bonds, and international stocks and bonds.

When it came to average performance by category during the three-year period, the race went to conservative funds that took few chances. International bond funds, roaming the globe for the best interest rates and helped by a general rise in foreign currencies against the dollar, did best. The ace in this group was **Paine Webber Master Global**, with an average yearly return of 14.7%.

The best-performing fund of all, however, was a stock fund that triumphed despite the period's handicaps. **Gabelli Growth** scored a 16.3% yearly return, miles ahead of the 1% average for all growth funds. Meanwhile, **Kaufmann Fund** grew at a respectable 10.4% clip even though aggressive growth funds were losing money at an average 2.3% a year. (To learn how the managers of Kaufmann and other top funds are investing now, see the interviews that follow.)

Not all mutual funds were considered in these rankings. To make the cut, they must



be diversified geographically and by industry. Thus, the **Japan Fund** and other single-country funds do not qualify, nor do sector funds that concentrate on one industry. Another requirement: The fund must have been managed by the same person during the entire three-year span. For funds with multiple managers, at least one must have stayed around. Finally, the fund must be open to new investors.

STELLAR PERFORMANCE is a powerful reason to invest in a fund. But you should also carefully consider costs, which are shown in the rankings along with other important data. Some funds charge a front-end sales load, not reflected in the performance figures on the lists, which can run as high as 8.5%. Investors in funds that bested the market, such as **Templeton Foreign** and **Oppenheimer Global**, more than recouped this charge. But when the fund performs poorly, the sales load adds insult to injury. A handful of funds have no front-end load but levy a charge when you exit.

Every fund has annual expenses—management fees, and in some cases, "12b-1" promotional fees allowed by the Securities and Exchange Commission rules. Together these average around 1% of assets, even in no-load funds. But the fees, which are accounted for in the performance data, can be as high as 3.5% at small funds with few investors.

Often disregarded by investors, but extremely significant, is a fund's portfolio turnover. This is a measure of how often a fund buys and sells stocks. For instance, a fund with 100% turnover changes its stock holdings completely over the course of a year. The brokerage commissions, not included in management fees, can nibble at a fund's performance. Worse, the investor can be hit with sizable taxes on capital gains distributions if the winnings are big. More attractive are funds like **Pasadena Fundamental Value**, which has achieved outstanding gains primarily on paper while holding its turnover to 24%.

Finally, you should examine the fund's level of risk. In measuring this, Morningstar looks at the variability of a fund's performance. If the monthly return often lags behind the return on 90-day Treasury bills, the fund is considered high risk. This does not necessarily mean that the fund is a bad investment—it may have roared past T-bills—but that it gives a bumpier ride. Because Morningstar watches fluctuations over several years, junk bonds don't yet show up as high risk despite their recent troubles, but only "above average" in most cases. If you like to sleep soundly, you may want to limit your selection to mutual funds with "low" or "below average" risk ratings.

Stellar performance is a powerful reason to invest in a fund. But you should also consider its costs.

Still another option is to abandon the idea of trying to beat the market at all. **Vanguard Index 500**, a no-load fund managed by Vanguard Group in Valley Forge, Pennsylvania, and not on these lists, is designed to shadow the S&P 500. Its three-year average return of 2.5% trailed the index a bit, but a minuscule management fee—recently 0.21%—accounts for most of the discrepancy. The risk level is just what you'd expect: "average." F

REPORTER ASSOCIATE *Rahul Jacob*

THE TOP FUNDS BY CATEGORY

MUTUAL FUND TELEPHONE	AVG. ANNUAL RETURN[1] 3 years	 1 year	ASSETS 6/30/90 in millions	FEES Sales load	 Annual expenses	PORTFOLIO TURNOVER	RISK	MANAGER
AGGRESSIVE GROWTH STOCK FUNDS								
Kaufmann 800-237-0132	**10.4%**	-8.5%	**$53**	None	3.50%	**202%**	Above avg.	H. Utsch, L. Auriana
Delaware Group Value 800-523-4640	**6.0%**	-15.7%	**$10**	4.75%	1.72%	**59%**	Above avg.	Edward Trumpbour
Fidelity Cap. Apprec. 800-544-8888	**5.1%**	-14.0%	**$2,074**	2.00%	1.36%	**62%**	Below avg.	Thomas Sweeney
Thomson Opportunity 800-628-1237	**2.8%**	-9.1%	**$44**	5.00%[2]	1.70%	**153%**	Above avg.	Don Chiboucas
General Aggressive Growth 800-645-6561	**2.3%**	-3.9%	**$49**	None	1.16%	**130%**	Average	Tom Frank
Putnam Voyager 800-225-1581	**2.1%**	-10.1%	**$804**	5.75%	1.25%	**71%**	Above avg.	Matthew Weatherbie
SLB Aggressive Growth 212-528-2744	**1.7%**	-6.5%	**$107**	5.00%	1.25%	**8%**	Above avg.	R. Freeman, E. Fried
AIM Constellation 800-347-1919	**1.0%**	-7.9%	**$129**	5.50%	1.71%	**149%**	High	H. Hutzler, J. Schoolar
MetLife-S.S. Capital Apprec. 800-882-0052	**0.9%**	-13.3%	**$59**	4.50%	1.50%	**223%**	Above avg.	Frederick Kobrick
Founders Special 800-525-2440	**0.6%**	-17.6%	**$71**	None	1.19%	**151%**	Above avg.	Bjorn Borgen et al.
GROWTH STOCK FUNDS								
Gabelli Growth 800-422-3554	**16.3%**	-3.4%	**$199**	None	1.85%	**48%**	Below avg.	Elizabeth Bramwell
Pasadena Fundmtl. Value 800-882-2855	**14.3%**	-1.6%	**$5**	5.50%	2.30%	**24%**	Low	Roger Engemann
Janus 800-525-3713	**10.3%**	-5.0%	**$1,246**	None	0.92%	**205%**	Below avg.	James P. Craig
Mathers 800-962-3863	**9.2%**	11.7%	**$244**	None	1.01%	**303%**	Low	H. Van der Eb Jr.
Gabelli Asset 800-422-3554	**8.6%**	-10.7%	**$381**	None	1.26%	**49%**	Low	Mario J. Gabelli
Carnegie-Cappiello Trust 800-321-2322	**8.3%**	-8.1%	**$78**	4.50%	1.59%	**52%**	Average	Frank Cappiello
Pasadena Growth 800-882-2855	**8.2%**	-12.1%	**$52**	5.50%	2.30%	**94%**	Above avg.	Roger Engemann

[1]Performance is net of annual expenses and brokerage costs but excludes sales loads.
[2]Deferred sales charge, which declines over time.

SOURCE: MORNINGSTAR INC.

MUTUAL FUND TELEPHONE	AVG. ANNUAL RETURN[1] 3 years	1 year	ASSETS 6/30/90 in millions	FEES Sales load	Annual expenses	PORTFOLIO TURNOVER	RISK	MANAGER
GROWTH STOCK FUNDS cont'd								
G.T. America Growth 800-824-1580	**8.1%**	2.9%	**$68**	4.75%	1.94%	**133%**	Above avg.	Scott Fearon
SteinRoe Special 800-338-2550	**8.1%**	−1.1%	**$451**	None	0.75%	**85%**	Average	R. Weiss, C. Murphy
IDEX 800-237-3055	**7.7%**	−4.6%	**$93**	8.50%	1.40%	**97%**	Average	Thomas Marsico
GROWTH & INCOME STOCK FUNDS								
Cigna Value 800-572-4462	**9.4%**	4.2%	**$91**	5.00%	1.00%	**152%**	Below avg.	James Giblin
Rightime Blue Chip 800-242-1421	**7.3%**	3.8%	**$123**	4.75%	2.56%	**233%**	Low	D. Rights, A. Soslow
SBSF Growth 800-422-7273	**6.8%**	3.8%	**$100**	None	1.13%	**44%**	Low	Louis Benzak
FPA Perennial 800-421-4374	**6.6%**	−2.2%	**$59**	6.50%	1.20%	**27%**	Low	Chris Linden
AIM Charter 800-347-1919	**6.4%**	7.4%	**$90**	5.50%	1.37%	**131%**	Below avg.	Julian Lerner
General Securities 800-331-4923	**6.3%**	−1.5%	**$20**	5.00%	1.39%	**54%**	Low	Jack Robinson
U.S. Boston G&I 617-259-1144	**5.7%**	−3.6%	**$37**	1.00%[3]	1.85%	**92%**	Average	J. Kimball Dow
Plymouth I&G 800-522-7297	**5.2%**	−5.4%	**$62**	4.75%	1.88%	**257%**	Low	Robert Hober
Merrill Lynch Cap. Apprec. A 800-367-3863	**5.2%**	−0.3%	**$945**	6.50%	0.78%	**85%**	Low	Ernest Watts
Copley 800-424-8570	**4.7%**	−4.2%	**$30**	None	1.86%	**3%**	Low	Irving Levine
EQUITY INCOME STOCK FUNDS								
Lindner Dividend 314-727-5305	**7.4%**	−1.4%	**$153**	None	0.87%	**2%**	Low	Eric E. Ryback
United Income 800-366-5465	**7.2%**	−8.5%	**$1,742**	8.50%	0.65%	**61%**	Below avg.	Russell Thompson
Capital Income Builder 800-421-0180	**7.0%**	0.5%	**$222**	5.75%	1.11%	**16%**	Low	Stephen Bepler et al.
Financial Industrial Income 800-525-8085	**6.8%**	0.0%	**$572**	None	0.79%	**124%**	Below avg.	John Kaweske
Oppenheimer Eq.-Inc. 800-525-7048	**4.6%**	−2.5%	**$1,329**	8.50%	0.85%	**116%**	Low	D. Jarmusz, S. Wilder
Keystone America Eq.-Inc. 800-343-2898	**3.9%**	−2.4%	**$24**	4.00%[4]	2.00%	**50%**	Below avg.	Walter McCormick
Founders Eq.-Inc. 800-525-2440	**3.8%**	−6.7%	**$15**	None	1.55%	**85%**	Low	Bjorn Borgen et al.
T. Rowe Price Eq.-Inc. 800-638-5660	**3.5%**	−14.1%	**$1,002**	None	1.14%	**18%**	Below avg.	T. Broadus, B. Rogers
SteinRoe Total Return 800-338-2550	**2.9%**	−3.2%	**$140**	None	0.88%	**93%**	Low	Robert Christensen
American National Income 800-231-4639	**2.7%**	−1.4%	**$74**	8.50%	1.17%	**15%**	Below avg.	James McGlynn
SMALL COMPANY STOCK FUNDS								
Alger Small Capitalization 800-992-3863	**12.0%**	−1.8%	**$31**	5.00%[2]	3.25%	**441%**	Above avg.	David Alger
Founders Frontier 800-525-2440	**11.6%**	−14.1%	**$71**	None	1.50%	**198%**	Average	Bjorn Borgen et al.
Janus Venture 800-525-3713	**8.9%**	−4.2%	**$232**	None	1.28%	**219%**	Below avg.	James P. Craig
Nicholas Ltd. Edition 414-272-6133	**5.4%**	−9.2%	**$72**	None	1.12%	**19%**	Below avg.	Albert Nicholas
Baron Asset 800-992-2766	**5.0%**	−26.0%	**$55**	2.00%[2]	1.78%	**94%**	Average	Ronald Baron
Columbia Special 800-547-1707	**4.7%**	−13.2%	**$142**	None	1.36%	**129%**	Above avg.	Alan Folkman
Twentieth Century Giftrust 800-345-2021	**4.0%**	−11.6%	**$33**	None	1.00%	**132%**	High	James Stowers et al.
Skyline Special Equities 800-458-5222	**3.7%**	−5.1%	**$26**	3.85%	1.60%	**90%**	Average	William Dutton
Twentieth Century Ultra 800-345-2021	**3.5%**	−6.7%	**$398**	None	1.00%	**166%**	High	James Stowers et al.
Hartwell Emerging Growth 800-624-3863	**3.3%**	−0.4%	**$29**	4.75%	2.50%	**136%**	High	John Hartwell
INTERNATIONAL STOCK FUNDS								
Templeton Foreign 800-237-0738	**11.6%**	16.3%	**$881**	8.50%	0.81%	**17%**	Low	Mark Holowesko
Ivy International 800-235-3322	**8.7%**	4.3%	**$80**	None	1.80%	**23%**	Below avg.	Hakan Castegren
Oppenheimer Global 800-525-7048	**8.4%**	21.0%	**$809**	8.50%	1.90%	**48%**	Average	Kenneth Oberman
Scudder Global 800-225-2470	**8.3%**	1.5%	**$257**	None	1.98%	**58%**	Below avg.	William Holzer
EuroPacific Growth 800-421-0180	**8.0%**	10.6%	**$805**	5.75%	1.24%	**26%**	Below avg.	Stephen Bepler et al.
First Investors Global 800-423-4026	**7.9%**	11.4%	**$246**	6.90%	2.05%	**155%**	Average	D. Duane, W. Higgins
G.T. International Growth 800-824-1580	**7.5%**	6.1%	**$348**	4.75%	1.85%	**82%**	Below avg.	Christian Wignall
Vanguard World International 800-662-7447	**5.7%**	5.3%	**$828**	None	0.64%	**50%**	Average	Richard Foulkes
Scudder International 800-225-2470	**5.7%**	7.2%	**$935**	None	1.18%	**49%**	Average	Nicholas Bratt
T. Rowe Price Int'l Stock 800-638-5660	**5.4%**	6.4%	**$1,163**	None	1.05%	**48%**	Average	Martin Wade et al.

[1] Performance is net of annual expenses and brokerage costs but excludes sales loads.
[2] Deferred sales charge, which declines over time.
[3] Redemption fee.
[4] Includes 2% deferred sales charge.

MUTUAL FUND TELEPHONE	AVG. ANNUAL RETURN 3 years	 1 year	ASSETS 6/30/90 in millions	FEES Sales load	 Annual expenses	PORTFOLIO TURNOVER	RISK	MANAGER
BALANCED FUNDS								
National Total Income 800-356-5535	**6.7%**	−5.3%	**$224**	5.75%	1.22%	**19%**	Below avg.	John Doney
Pax World 800-767-1729	**5.9%**	7.0%	**$108**	None	1.10%	**37%**	Average	Anthony Brown
Phoenix Balanced 800-243-4361	**5.7%**	5.5%	**$489**	6.90%	0.88%	**144%**	Below avg.	Patricia Bannan
Vanguard STAR 800-662-7447	**4.7%**	−7.0%	**$1,077**	None	0.43%	**7%**	Average	(group of funds)
Dodge & Cox Balanced 415-434-0311	**4.7%**	−1.6%	**$62**	None	0.72%	**12%**	Average	Joseph Fee et al.
Mass. Finan. Total Return 800-225-2606	**4.4%**	−3.0%	**$748**	4.75%	0.86%	**53%**	Average	Richard Dahlberg
American Balanced 800-421-0180	**4.1%**	−5.0%	**$310**	5.75%	0.78%	**37%**	Average	George Miller et al.
Eaton Vance Investors 800-225-6265	**3.9%**	0.1%	**$205**	4.75%	0.92%	**56%**	Average	M. Dozier Gardner
Strong Investment 800-368-3863	**3.9%**	−2.6%	**$230**	1.00%	1.30%	**236%**	Below avg.	R. Strong, W. Corneliuson
Wellington 800-662-7447	**3.8%**	−6.0%	**$2,331**	None	0.42%	**30%**	Average	Vincent Bajakian
CONVERTIBLE BOND FUNDS								
Convertible Securities 800-356-2805	**5.5%**	−11.7%	**$29**	4.50%	0.97%	**54%**	Average	J. Madden, M. Durbiano
Phoenix Convertible 800-243-4361	**4.7%**	5.9%	**$152**	6.90%	1.02%	**143%**	Below avg.	John G. Martin
Pru-Bache IncomeVert. + B 800-225-1852	**3.1%**	−8.2%	**$513**	5.00%[2]	2.03%	**91%**	Average	Terry Hamacher
American Capital Harbor 800-421-5666	**2.9%**	−2.0%	**$377**	5.75%	0.76%	**94%**	Average	James Behrman
Lord Abbett Bond-Deb. 800-874-3733	**2.8%**	−5.4%	**$594**	4.75%	0.59%	**124%**	Below avg.	Robert S. Dow
JUNK BOND FUNDS								
Plymouth High-Yield 800-522-7297	**8.2%**	1.7%	**$16**	4.75%	1.10%	**115%**	Above avg.	Margaret Eagle
Merrill Lynch High-Income A 800-637-3863	**6.1%**	1.9%	**$542**	4.00%	0.68%	**56%**	Average	Vincent T. Lathbury
Investment Series 800-245-4770	**4.7%**	−4.6%	**$5**	5.75%	1.14%	**38%**	Above avg.	J. Madden, M. Durbiano
Financial Bond High-Yield 800-525-8085	**4.4%**	−4.1%	**$50**	None	0.83%	**53%**	Above avg.	William Veronda
Cigna High-Yield 800-833-0951	**4.2%**	−6.4%	**$250**	5.00%	1.10%	**36%**	Above avg.	Alan Petersen
MORTGAGE-BACKED BOND FUNDS								
SFT U.S. Government 800-523-2044	**11.2%**	11.0%	**$31**	5.00%	1.32%	**20%**	Low	Andrew Groshans
Smith Barney Mthly. Gov't 800-544-7835	**10.3%**	8.2%	**$21**	4.00%	0.46%	**11%**	Average	Ellen Bermel
Vanguard Fixed-Inc. GNMA 800-662-7447	**10.3%**	8.8%	**$2,271**	None	0.30%	**9%**	Average	Paul Sullivan
Benham GNMA Income 800-472-3389	**10.1%**	8.3%	**$310**	None	0.75%	**433%**	Average	Randy Merk
Investors Preference 800-322-5353	**10.0%**	9.2%	**$40**	4.00%	0.60%	**5%**	Below avg.	Regis Dompka
TREASURY BOND FUNDS								
Dreyfus U.S. Gov't 800-648-9048	**8.9%**	3.2%	**$24**	None	1.32%[3]	**40%**	Above avg.	Barbara Kenworthy
Vanguard U.S. Treasury 800-662-7447	**8.7%**	0.6%	**$628**	None	0.28%	**83%**	Above avg.	Ian MacKinnon
Principal Preserv. Gov't 800-826-4600	**8.5%**	6.3%	**$29**	4.50%	1.20%	**142%**	Average	Vern Van Vooren
Dreyfus U.S. Gov't Interm. 800-648-9048	**8.4%**	7.2%	**$62**	None	0.80%	**6%**	Average	Barbara Kenworthy
Federated Interm. Gov't 800-245-5000	**8.2%**	7.9%	**$894**	None	0.51%	**166%**	Below avg.	Roger A. Early
MUNICIPAL BOND FUNDS								
UST Master Tax-Exempt L-T 800-233-1136	**11.2%**	5.6%	**$35**	4.50%	0.85%	**437%**	Below avg.	Kenneth McAlley
Alliance Muni. Income Nat'l 800-227-4618	**9.9%**	6.0%	**$181**	4.50%	0.56%	**216%**	Below avg.	Susan Peabody
Rochester Municipals 716-442-5500	**9.7%**	8.0%	**$156**	4.00%	0.75%	**35%**	Low	Ronald Fielding
Financial Tax-Free 800-525-8085	**9.0%**	4.6%	**$179**	None	0.74%	**27%**	High	William Veronda
United Municipal Bond 816-283-4122	**8.8%**	3.6%	**$653**	4.25%	0.57%	**226%**	High	John Holiday
INTERNATIONAL BOND FUNDS								
Paine Webber Master Global 800-647-1568	**14.7%**	19.6%	**$1,105**	5.00%[2]	1.95%	**124%**	Below avg.	Nimrod Fachler
Van Eck World Income 800-221-2220[4]	**14.0%**	20.0%	**$43**	4.75%	1.60%	**290%**	Below avg.	K. Buescher, D. Kenerson
Mass. Financial Int'l 800-225-2606	**12.8%**	17.8%	**$122**	4.75%	1.64%	**282%**	Average	Leslie J. Nanberg
M. Lynch Retrmt. Global B 800-637-3863	**11.3%**	16.0%	**$264**	4.00%[2]	1.78%	**188%**	Above avg.	D. Water, L. Teitelbaum
T. Rowe Price Int'l Bond 800-638-5660	**7.0%**	13.5%	**$306**	None	1.14%	**293%**	High	David Boardman

[1] Performance is net of annual expenses and brokerage costs but excludes sales loads.
[2] Deferred sales charge, which declines over time.
[3] Currently absorbed by the management company.
[4] 212-687-5200 in New York State.

MUNIS: THE LAST OF THE TAX HAVENS

WITH HIGHER TAXES BREWING FROM CAPITOL HILL TO CALIFORNIA, MUNICIPAL BONDS LOOK BETTER THAN EVER.

BY SUSAN E. KUHN

YOUR TAX RATES now may be the lowest you will ever see. Fiscal crises from New York to California suggest that they won't last much longer. Faced with likely increases, and with many of the tax shelters of yore a distant memory, where can an investor look for refuge from the taxman's bite? About the best answer going: municipal bonds, which pay interest that goes into no one's pocket but your own.

Municipals, those boring little bonds you and your fellow citizens have been approving lately for new sewers and bridges and prisons, have been magnificent for months and are likely to remain so. Munis have consistently offered yields equal to 80% or more of those on Treasury securities. At that spread, anyone in the 28% or 33% federal tax bracket will save money owning a municipal.

The tax fever gripping many legislatures makes munis only more attractive. In the fiscal year just ended, 23 states raised taxes, ten of them socking it to personal income. Next year could be worse. Says Corina Eckl of the National Conference of State Legislatures, which tracks state budgets: "States have already made major cuts and used one-time revenue boosts. Many got by this year, but they may have to raise taxes next year."

Even if investors escape tax swipes from their state, they may have to dodge higher taxes from Washington. Wealthy residents of high tax states like California and Arizona could be threatened if the proposal to limit itemized deductions, such as state and local taxes, is adopted. Observes Peter Allegrini, a municipal bond portfolio manager

Bonds issued to maintain the Benjamin Franklin Bridge into Philadelphia are tax-free in Pennsylvania and New Jersey.

NINA BARNETT

for Fidelity: "When George Bush came out saying, 'We're raising taxes,' munis gained a lot of favor."

Concludes Allegrini: "Demand will be very, very strong and will outpace supply." But supply there will be, enough to give investors a healthy measure of choice. Those same big, fiscally unhealthy states Eckl talks about are also big issuers of municipal bonds. California, New York, and Texas, each of which may have to raise taxes, together account for more than one-quarter of all munis issued annually.

ALAN D. LEVENSON

AMT bonds finance a new runway for Las Vegas's McCarran airport.

BEFORE YOU BUY any muni, it's important to know your state's rules on the taxability of interest income from municipal bonds. Most states exempt interest earned on local bonds but tax the interest on out-of-state issues. Indiana, New Mexico, and Utah are particularly generous: They extend the tax break to all munis. Illinois, Iowa, Oklahoma, and Wisconsin are probably the stingiest, exempting only certain in-state bonds.

Knowing a bit about the types of muni bonds available can make a difference in assessing the riskiness of your investment. General obligation, or GO, bonds are usually safer, so they yield from 0.15 to two percentage points less than revenue bonds. That's because GO bonds are backed by the taxing authority of a city or state, while revenue bonds depend upon income streams from a particular project—a new airport, for example. Apart from the bonds of fiscally strapped Louisiana and Massachusetts, all state GO bonds carry single-A or better ratings. Eleven states have triple-A ratings. But don't count revenue issues out because of risk. The bonds issued by the Delaware River Port Authority, for instance, are triple-A because they are backed by tolls on the bridges connecting New Jersey and Pennsylvania—a revenue source unlikely to dry up.

One way of reducing risk is to buy an insured bond, whose interest and principal are guaranteed in the case of default. In less than ten years, new issues of insured bonds have ballooned from $2 billion a year to $31 billion. In the process, the yield you give up to own an insured bond of the same rating has declined, to about 0.1%. Says John Sebastian of the Chicago brokerage firm Clayton Brown & Associates: "Insured bonds are a good buy, and owning one is like having a belt *and* suspenders."

In the year just ended, 23 states raised taxes, ten socking personal income. Next year could be worse.

Income from some revenue bonds, particularly those issued to finance airport construction or the building of waste-to-energy plants, are subject to the 21% alternative minimum tax, or AMT. That tax, you'll recall, requires you to add back to your gross income a host of "preference items," such as gains on incentive stock options, and disallowed deductions, such as state and local taxes. If the 21% tax on this adjusted gross income is greater than the tax you would normally fork over, you have to pay the AMT. Because most investors don't want to even *think* about that possibility, notes Steven Hueglin of the New York brokerage firm Gabriele Hueglin & Cashman, issuers often have to jack up the yield on AMT bonds to sell them.

So how to take the investment plunge into municipals? If you can assemble a $50,000 portfolio of up to five issues that you intend to hold to maturity, you may want to buy bonds on your own rather than to buy into a muni mutual fund. In states like Illinois you have little choice: Because the state exempts only certain issues, fund managers can't make a go of it.

IF YOU DO go out on your own, be warned, though: Selling *any* municipal bond before its time gets tricky. The market for munis is less liquid than the one for, say, Treasuries. Obtaining financial information about muni issuers can be difficult, and many issuers are small localities that come to the market infrequently. Some issuers, like the Power Authority of the State of New York, are familiar faces, so their bonds are always good bets if you think you might have to cash out early. But if you sell a block of munis from a little-known issuer, you may be able to realize only 95% of the face value.

The easiest way to invest in munis, if you don't mind paying some fees, is to buy in through a mutual fund. National funds that buy bonds from any state are fine if you are most concerned with ducking federal taxes,

REPORTER ASSOCIATE *Alison L. Sprout*

but if you want the state and local pass-through, a state bond fund is obviously the way to go.

In states that have high taxes and plenty of issuers, you'll typically find an abundance of funds to choose from. Lipper Analytical Services tracks nearly 300 single-state funds in 30 states. California and New York lead the list, with 58 and 49 funds, respectively. It pays to look around, not just for yield but also to save on costs. Mutual funds usually charge an annual management fee of about 0.5%, but sales charges can range from nothing to 8.5%. Sponsors of no-load single-state funds include big names such as Vanguard, Fidelity, Dreyfus, Scudder Stevens & Clark, and T. Rowe Price Associates.

Finding a fund manager for your state is getting easier all the time: Some 100 firms sponsor single-state muni bond funds nowadays. Franklin Fund of San Mateo, California, started its municipal department in 1977 and now offers portfolios in 24 states, charging a maximum sales load of 4%. Its largest muni fund, the $11 billion Franklin California Tax-free Income Fund, is the biggest muni fund in the country, and its average 12-month yield, 7.5%, tops the list for the state. Californians in the 28% federal bracket seeking sunny yields like that in a CD would have to find a bank offering 11.5%.

ANOTHER GOOD BET for single-state funds is J&W Seligman of New York, which offers 19 funds in 18 states. Notes Thomas G. Moles, senior portfolio manager for munis: "When we started in 1983, most muni players were in California and New York. We looked at other state tax scales and said, 'Why wouldn't it work in Massachusetts, Minnesota, and Maryland?' " South Carolinians can now benefit from that pioneering spirit. Seligman's fund in that state charges a maximum 4.75% load and yields 6.6%, for a CD-equivalent yield of 9.9%.

Many fund managers try to achieve diversification by mixing high yields (say, from AMT issues) with high quality (from top-notch or insured bonds). Arranging a cornucopia is easy in large states like California, but more difficult in smaller or less populous states. To provide safety in troubled states (think Massachusetts), many firms offer insured funds, which hold only bonds that are insured by triple-A financial guaranty companies.

Another alternative is to investigate unit investment trusts, which sell a fixed, unmanaged package of securities. UITs are forever wedded to the price fluctuations of the original bonds purchased. They have existed since the 1950s, so they may be more available than muni mutual funds. Investors in a UIT are typically charged an up-front sales commission of 4% to 6%, followed by annual trustee fees, which amount to 0.1%. Whichever route you choose, you should still come out ahead of the taxman. F

HOW MUNIS STACK UP STATE BY STATE

STATE	TOP STATE TAX RATE	STATE MUNI YIELD	To match the muni yield, you'd need to get the following yields from . . . TREASURIES	CDs
Alabama	5.0%	7.3%	10.1%	10.7%
Arizona	8.0%	6.9%	9.6%	10.4%
Arkansas	7.0%	7.1%[4]	9.9%	10.6%
California	9.3%	6.7%	9.3%	10.3%
Colorado	5.0%	7.0%	9.7%	10.2%
Connecticut	14.0%	6.8%	9.4%	11.0%
Delaware	7.7%	6.7%[4]	9.3%	10.4%
Florida	None	7.6%	10.6%	10.6%
Georgia	6.0%	6.6%	9.2%	9.8%
Hawaii	10.0%	6.6%	9.2%	10.2%
Idaho	8.2%	6.2%	8.6%	9.7%
Indiana	3.4%	7.4%	10.3%	10.6%
Kansas	6.0%[5]	6.9%[4]	9.6%	10.5%
Kentucky	6.0%	6.6%	9.2%	9.8%
Louisiana	6.0%	6.9%	9.6%	10.2%
Maine	8.5%	6.8%[4]	9.4%	10.3%
Maryland	7.5%[5]	6.5%	9.0%	10.1%
Massachusetts	6.0%[6]	6.9%	9.6%	10.2%
Michigan	4.6%	6.7%	9.3%	9.8%
Minnesota	8.5%	6.6%	9.2%	10.4%
Missouri	6.0%	6.8%	9.4%	10.1%
Nebraska	6.4%	6.6%[4]	9.2%	10.1%
New Jersey	7.0%[7]	6.8%	9.4%	10.2%
New York	7.9%	6.7%	9.3%	10.1%
North Carolina	7.0%	6.6%	9.2%	9.9%
North Dakota	3.9%[5,8]	7.2%	10.0%	10.4%
Ohio	6.9%	6.7%	9.3%	10.0%
Oregon	9.0%	6.2%	8.6%	9.5%
Pennsylvania	2.1%	7.0%	9.7%	9.9%
Rhode Island	6.4%[8]	6.7%	9.3%	9.9%
South Carolina	7.0%	6.5%	9.0%	9.7%
Tennessee	6.0%	6.7%	9.3%	9.9%
Texas	None	7.5%	10.4%	10.4%
Vermont	7.8%[8]	6.7%[4]	9.3%	10.0%
Virginia	5.8%	6.5%	9.0%	9.6%
West Virginia	6.5%	6.7%	9.3%	10.0%

[1]Top tax rate (rounded) for interest income in 1990, as of August 31.
[2]Average 12-month yield through August for single-state municipal bond funds tracked by Lipper Analytical Services.
[3]Calculated by Coopers & Lybrand. Assumes a 28% tax rate.
[4]Average 12-month yield through August for single-state unit investment trusts sponsored by Clayton Brown & Associates.
[5]Applies to most taxpayers. Alternate rates may apply.
[6]Rate applies only to in-state CDs.
[7]Effective rate for 1991.
[8]State rates are derived from a percentage of federal taxes paid.

THE NEW RULES OF SUING A BROKER

SURPRISE! SETTLING DISPUTES THROUGH ARBITRATION RATHER THAN IN COURT WORKS OUT WELL FOR INVESTORS. ■ BY LLOYD S. CLAREMAN

HOW MANY industries can you name in which large, well-financed corporations have, with much fanfare, made it as easy and inexpensive as possible for the public to sue them? I can think of just one: the securities industry.

The key is in those agreements that brokerage firms frequently make you sign requiring that any disputes between you and the firm be arbitrated rather than taken to court. Oddly, investors still widely believe that these agreements deprive them of some immensely valuable right. To this day, even in the face of Supreme Court rulings upholding the validity of such agreements, unhappy investors labor mightily to get into court and away from arbitration. The financial press doesn't help, often describing judicial decisions compelling arbitration as "setbacks" for the investing public.

This prevailing view of arbitration—as conducted under today's rules, not those of just a few years ago—is misguided. Anyone who thinks he is automatically better off litigating a securities case in court should consider the Florida doctor who sued his brokerage firm when a $150,000 tax shelter investment didn't live up to his expectations. After *four years* of pretrial proceedings, the case finally made it to trial. The jury, fundamentally unsympathetic to the wealthy plaintiff, ruled against him on every claim. His lawyers had racked up fees of over $100,000—and under Florida law he was liable to the brokerage firm for *its* legal fees. You think a jury would be more likely to take pity on you than on a wealthy doctor? Consider the wheelchair-bound paraplegic who sued his broker in Florida a couple of years ago and also lost and had to pay his broker's lawyers.

No one can know what the results would have been had either case been arbitrated. But as an attorney who has handled securities cases in both arenas, I believe that instead of attempting to avoid arbitration, or bemoaning it, aggrieved investors should learn how to exploit its many advantages.

An important reason many investors resist securities arbitration is that they remember it the way it used to be, which was emphatically a bad bet for them. While only one of the three arbitrators on the panel that decided a customer's case would come from the securities industry, the other two "public" arbitrators were apt to be people with close industry ties. Punitive damages were practically unheard of, and a customer had virtually no prehearing access to information in the brokerage firm's possession ("smoking gun" memos and other internal documents) that he might need to present an effective case. Another reason brokers preferred arbitration: It was easier and cheaper for their in-house lawyers to handle. The customer could choose between arbitration and the courts, but since arbitration under these conditions was so favorable to brokerage firms, the firms tried to get *every* case into that forum.

TIMOTHY GREENFIELD-SANDERS

Author Clareman: Most investors don't know that arbitration today is quick, inexpensive, and fair.

The industry seemed to get its way in mid-1987 when the Supreme Court ruled that clauses in standard customer-broker agreements requiring arbitration of disputes are enforceable. But this "victory" focused attention on arbitration and widened the view that it could be made a lot fairer. Soon after, the Securities and Exchange Commission suggested to the industry that it adopt a number of reforms. The industry complied.

As a result of these reforms, the effects of which are just beginning to be felt, most of the investor's disadvantages in arbitration have been swept away. One of the arbitrators on a panel may still be from the securities industry, but the public members must be what their name implies; anyone with a meaningful tie to the industry is disqualified or must be counted as the industry arbitrator. In practice, arbitrators are often business people, lawyers, and retirees from these professions. Increasing numbers of investors are asking for and being awarded punitive damages, notwithstanding con-

LLOYD S. CLAREMAN, *a Manhattan attorney, has been active in securities litigation for 14 years.*

flicting legal decisions about the power of arbitrators to award such damages. Investors get more prehearing access to brokerage firms' data. More pro-investor reforms are constantly being proposed.

RESULT: Arbitration today offers more advantages than disadvantages to aggrieved investors. A dissatisfied customer who might not otherwise have thought of suing, or who would have shunned the prospect of getting involved in an arduous litigation, can now contemplate going to a reasonably evenhanded arbitration in which all he needs to do is file a complaint and then show up for the hearing. To learn how to initiate action, he can just call the arbitration department of any of the exchanges or other organizations specified in his customer's agreement. Hearings are held in virtually every major U.S. city. Cases are handled so quickly—the typical claimant has to wait only six to eight months for his case to be heard—that legal fees don't have much chance to build up. Most investors can have their cases handled on a contingent-fee basis, paying their lawyers only if they win. A victorious investor usually gets a check in about 30 days—appeals are rare and almost never successful.

Despite all the public resistance, little hard evidence exists to suggest that the investor's results in arbitration are any worse than those he gets in court—and he certainly gets them faster and at vastly lower expense. It is not widely appreciated that securities cases filed in the courts are often dismissed before they get off the ground. A complaint generally has to survive an initial motion to dismiss, usually because the allegations are claimed to be substantively or technically deficient. If the case gets past that stage—and many do not—years of pretrial discovery may ensue. At the conclusion will be another round of motions aimed at getting the case dismissed for lack of substance. Only if it survives these obstacles will the case get before a jury. And a favorable outcome with the jury, if it occurs, may always be set aside by the judge or reversed on appeal in the distant future.

REPORTER ASSOCIATE *Sandra Kirsch*

Arbitration has no such hurdles. It is almost unprecedented for a case to be dismissed without a full hearing. Cases that in court would not survive an initial dismissal motion due to some clear legal defect (expiration of the statute of limitations, for example) may nonetheless result in an arbitration award if the panel of arbitrators, after hearing all the evidence, decides that granting an award is the right thing to do. No appellate court is waiting in the wings to second-guess that judgment, and no reasons for it need even be given.

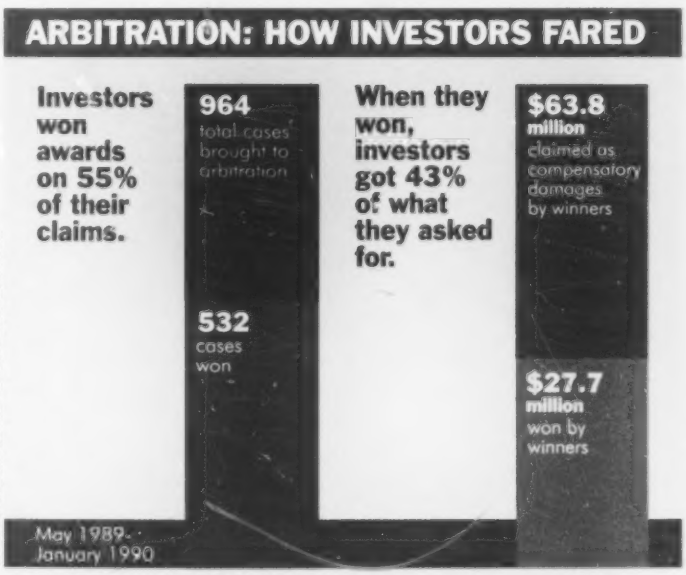
Arbitration panels have an inherent tendency to reach a compromise that gives the investor something.

The results can be surprising. A Houston doctor with extensive business experience (and a history of speculating in the securities markets) opened a brokerage account a couple of years ago with $100,000 in cash. He signed a number of forms giving his broker control of the account and stated in writing that he wanted the broker to run a high-risk trading account, as opposed to taking a conservative buy-and-hold approach. Over 18 months the account lost $20,000, mainly due to commissions on the aggressive trading the investor had authorized. He received account statements every month showing all trades made on his behalf and the losses as they were being incurred, and he didn't object. He even signed so-called activity letters, when asked to do so by the brokerage firm, in which he specifically approved the trades made in his account.

Yet after closing the account, the investor brought a claim in arbitration asserting that the broker had engaged in inappropriate and excessive trading. The hearing lasted just one day and included a presentation by the brokerage firm of the numerous forms and approvals that the investor had signed. When it was over, the arbitrators awarded him $95,000, representing all the commissions earned by the broker over the life of the account, even though the investor's losses were only $20,000. The odds are high that this claim, if filed in court and subjected to attack under conventional legal principles, would have been dismissed by a judge before it ever got to trial.

While this investor did unusually well, arbitration often produces less spectacular but still satisfactory results for investors because of the inherent tendency of the three-member panel, free of the legal rules that bind judges and juries, to reach a compromise decision that gives the investor something. The most recent statistics indicate that more than half of all claimants in arbitration win some award. While it is usually less than the amount sought, the same may be said of most jury verdicts.

Suing your broker has never been easier. With arbitration it is fast and simple. There can be no war of attrition in which the deep-pocketed corporation, through artful court maneuvers, can outlast the customer's depleted resources or his patience. Don't be surprised if, a few years from now, your broker asks you to sign a new customer's agreement—and it doesn't contain an arbitration clause. F



Do investors make out better in court? No one knows. But their cases take more time and expense—and many don't make it to trial.